Accounting land hire purchase claims and ensuring accruals

Audit report No. OSII-2-6/06/90 of 6 November 2006

Summary

Upon payment for land privatised during the land reform, it is permitted to use hire purchase over a period of up to 50 years and the privatisers are provided with various incentives. Interest is calculated on the annual amount payable, not on the total amount outstanding. Thus, the use of hire purchase is considerably more expedient than a bank loan. Privatised land can be resold. Upon approval of the County Governor the amount outstanding calculated on favourable terms and conditions can be transferred to the new owner.

In the course of previous audits the State Audit has detected problems in the accounts of county governments regarding land hire purchase as well as upon ensuring the scheduled accrual of the payments. In 2003 the National Audit Office completed the audit "Risks of Privatisation of State Land by Hire Purchase," as a result of which recommendations were made to the Minister of Finance and the Minister of the Environment. Over the last three years most of the important problems that were pointed out have not been solved. To the knowledge of the National Audit Office the sale of the privatisation claims, among other things, has not been seriously considered.

The purpose of the audit is to assess the accounting of payment of hire purchase amounts for privatised land and the means taken for ensuring the accrual of the amounts receivable. Five county governments were included in the sample for the purpose of giving the assessment. To analyse the terms and conditions of the contracts a sample was formed of purchase and sale contracts, contracts in rem and contracts for the establishment of a mortgage. As of the end of 2004 the accounts of the county governments contained hire purchase receivables in the amount of EEK 2.2 billion, of which EEK 64.3 million had been indicated as uncollectible accounts. By the end of 2005 the amount of uncollectible accounts amounted to EEK 109.3 million. In 2004 EEK 386.7 million and in 2005 EEK 404.3 million accrued from the satisfaction of the hire purchase claims. In 2005, approx. EEK 7 million was used of the reserve fund of the ownership reform.

Main observations

1. The information technology databases of the county governments do not support ensuring the accrual of hire purchase payments for privatised land. The inadequacy of the databases does not allow for a thorough analysis or monitoring of payment of hire purchase amounts, as a result of which the probability of the accrual of the amounts payable will decrease and the cost of administration of the claims will increase.

2. Delaying the collection of the outstanding hire and purchase payments for privatised land generates a risk that in the case of the bankruptcy of the debtor the state will not receive the amount payable for the land. Due to the unclarity of the possibilities of compulsory execution and deficiencies of the system of administration of claims the hire purchase debts are let to grow in practice.

3. Usually, upon resale of the land the new owner is permitted to continue payments for the land to the state by way of hire purchase instead of demanding immediate payment of the entire purchase amount. Using hire purchase for payment for privatised land may have been justified at the time when bank loans were inaccessible to a large portion of privatisers, while the reorganisation of land ownership had to be promoted. By the present time the market price of land has increased, but bank loans are relatively easily available. Thus, granting the incentive to the successive buyers of the privatised land does not seem to be justified. The law does not detail with sufficient clarity the duties of the county governor upon protection of the interests of the state when selling privatised land. The law can be interpreted in such a manner than the county governor has the right to refuse continuance of the payment by hire purchase only on limited bases provided by law. An interpretation to the contrary is possible as well.

During the audit the National Audit Office also found minor accounting mistakes, which have been generalised and, where necessary, illustrated with examples in this report. Some of the mistakes were eliminated during the audit.

Main recommendations

To the Minister of the Interior

1. To introduce in all county governments a uniform computer program, which allows for reasonable administration of land hire purchase claims, creating the prerequisites for ensuring accrual of hire purchase payments and allowing for prevention of mistakes in accounting. Upon introduction of the new software or improvement of the existing software, the National Audit Office would like to keep in mind the following:

- The useful life of the program must ensure the administration of the contracts until expiry of the contracts.
- Acquisition of the software from the manufacturer who has developed the software (or from the official representative of the manufacturer) will make it easier to develop the program continuously and in the centralised manner and to provide all end users with user support. The provider of the program should equip the end user with expertise and training as a result of which the hire purchase accounting should be executed on the same bases and the outputs (e.g. to accounting) the same in all the county governments. The program should take the increase of the data volume into account and ensure smooth accounting of hire purchase even if the local users change. Centralised provision of the county governments with the expertise and version updates would be reasonable.
- The software should contain possibilities for performance of all the functions of hire purchase accounting pursuant to the Land Reform Act and the General Rules for State Accounting.
- The software should ensure making backup copies of data insertions and modifications in the database of hire purchase. It should also be possible to define the rights of the program user upon insertion of data and amendment thereof pursuant to their duties.

2. To consider establishment of a uniform procedure for inventory checks and analytical accounting of hire purchase receivables.

3. To improve inspection of the accounting data by the Ministry at the end of reporting periods when preparing the consolidated report on the area of government.

4. Upon delegation of entry into land privatisation contracts to the local government units, to take measures for ensuring timely and smooth receipt of information and documents from the local authority. Also, to check whether all the fees specified in the contract have been paid to the special account in the case of all the transferred contracts.

To the Minister of Regional Affairs and county governors

1. To analyse the contracts allowing for the use of hire purchase upon payment for privatised land in order to find the optimum possibilities for termination of the contract, unless the buyer makes the payments pursuant to the schedule. To commence the procedures for collection of the debts without delay. To consider the establishment of a procedure for collection of debts arising from failure to perform the contracts.

2. To appoint specific persons in the county governments who are responsible for protection of the interests of the state in bankruptcy proceedings and their duties.

To the Minister of the Environment

To consider the need to amend the Land Reform Act in such a manner that upon the transfer of privatised land the amount outstanding must be paid to the state immediately. If necessary, the county governor may be authorised to allow payment for privatised land by way of hire purchase in exceptional and essential circumstances. Furthermore, to stipulate the bases for termination of the contract in the Land Reform Act.

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In their replies **the county governors** stated that they agree with the main observations and recommendations made by the National Audit Office. The Tartu County Secretary acting in the capacity of the County Governor agreed with the observations and recommendations of the National Audit Office, but the letter will not be disclosed on the basis of clause 35 (1) 10) of the Public Information Act.

The Minister of the Environment agreed in principle with the recommendation of the National Audit Office to amend the Land Reform Act.

According to **the Minister of the Interior**, systematic development of the MIS program designed for administration of land hire purchase receivables, which would cover all the receivables (incl. the receivables of the five county governments not using MIS) and ensure high quality transfer of analytical information from the MIS database to the accounting information system, falls within the competence of the Ministry of Finance, because the Ministry of Finance is currently administering the central database.

The Minister of the Interior and the Minister of Regional Affairs have made a proposal to the Ministry of Finance to transfer the administration of the land hire purchase receivables to the Tax and Customs Board, which has the respective competence and national databases in order to ensure protection of the state's interests in bankruptcy proceedings.

According to the explanations of **the Minister of Finance**, the role of the Ministry of Finance has so far been confined to the technical support of MIS and development of accounting regulations. Due to the separation of the databases the Ministry of Finance is not directly involved in development work in each county government, although the money for the development of MIS has been allocated from the reserve fund of the ownership reform. Also, the Ministry of Finance has discussed the transfer of the MIS maintenance agreement with the Ministry of the Interior, because MIS operates in county governments, which are coordinated by the Ministry of the Interior. Therefore, the Ministry of the Interior should decide in which database the information should be maintained.

The National Audit Office finds that the issue is not merely in finding the technical solution, but that the whole range of issues pertaining to the administration of the land hire purchase receivables needs improvement. Thus, it is not reasonable to preserve and deepen the division of responsibility between various ministers. Differences regarding the division of responsibility between the Minister of the Interior, the Minister of Regional Affairs, the Minister of the Environment and the Minister of Finance need an urgent and clear solution and the National Audit Office cannot take the role of the decision-maker. Thus, the National Audit Office repeats its recommendation to all the ministers who are currently responsible for the administration of the land hire purchase receivables and accrual of respective sums.

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